

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the
California-American Water Company
(U210W) for an Order Authorizing it to
Increase its Rates for Water Service in its
Sacramento District to Increase Revenues by
\$8,198,700 in the Year 2003; and
\$1,955,000 in the Year 2004.

Application 02-09-030
(Filed September 19, 2002)

And Related Matters.

Application 02-09-031
(Filed September 19, 2002)
Application 02-09-032
(Filed September 19, 2002)
Application 02-09-033
(Filed September 19, 2002)

**COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES
ON THE PROPOSED DECISION OF ALJ MCVICAR**

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TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
I. INTRODUCTION	1
II. THE PROPOSED DECISION IS ERRONEOUS ON THE ISSUE OF RECOVERY OF GROUNDWATER CONTAMINATION CLEANUP COSTS AND MUST BE CORRECTED	2
III. RECOMMENDATION	5
IV. CONCLUSION	6
CERTIFICATE OF SERVICE	

TABLE OF AUTHORITIES

STATUTES:

PAGE

California Public Utilities Code	
§ 451	2,3

CASES:

CALIFORNIA SUPREME COURT:

<i>Cossmann v. DaimlerChrysler Corporation</i> (2003) 108 Cal.App. 4 th 370, 2003	
Cal.App. LEXIS 638	5

UNITED STATES SUPREME COURT:

<i>Kronisch v. United States</i> (1998) 1998 U.S. App. LEXIS 29363	4
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RULES OF PRACTICE AND PROCEDURE:

Rules 77.2-77.4	1
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I. INTRODUCTION

Pursuant to Rules 77.2 through 7.4 of the Commission's Rules of Practice and Procedure (Rules), the Commission's Office of Ratepayer Advocates, Water and Natural Gas Branch (ORA), hereby submits its Comments on the Proposed Decision of Administrative Law Judge (ALJ) McVicar, mailed on February 10, 2004. ORA and Cal-Am have entered an agreement, adopted in the Proposed Decision, concerning most of the issues in this proceeding, and ORA is satisfied with the ALJ's treatment of the remaining issues in his Proposed Decision, except one. That exception is the Proposed Decision's ratemaking treatment of the Sacramento district projects initiated to correct damage due to groundwater

contamination caused by third parties. The Proposed Decision's treatment is founded on both legal and factual error with respect to this issue, and must be corrected.

II. THE PROPOSED DECISION IS ERRONEOUS ON THE ISSUE OF RECOVERY OF GROUNDWATER CONTAMINATION CLEANUP COSTS AND MUST BE CORRECTED

The Proposed Decision correctly concludes that no dispute remains as to the prudence of the proposed actions. (PD, p. 17.) The Proposed Decision is also mostly correct in stating that ORA founds its argument on basic reasons (which the Proposed Decision characterizes as “principles”, “and (on) little further discussion”. ORA’s position is that the risk of third-party contamination should be borne by shareholders rather than by ratepayers because the contamination was known (or should have been disclosed by Cal-Am’s due diligence investigation) prior to the merger, and because placing the costs of alleviation into rate base will remove the incentive for Cal-Am to pursue the third parties.

These reasons and the position ORA takes based on them do not require further elaboration. They all derive from the mandate of § 451 of the California Public Utilities Code¹ that all charges be just and reasonable. Section 451 unquestionably states that:

All charges demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

¹ Unless otherwise noted, all statutory references herein are to the California Public Utilities Code.

Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities including telephone facilities², as defined in Section 54.1 of the Civil Code, as are *necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public.*

All rules made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable.

Section 451 (emphasis added). Thus, it is the responsibility of the utility, and of its predecessors, to ensure the safety of the water provided to Cal-Am's ratepayers, *not* that of the ratepayers. While the utility is entitled to ask the Commission for reimbursement in rates for its ordinary expenditures in pursuit of its responsibilities, the contamination cleanup is another matter. In cases like these, standard ratemaking practice is to allow the utility to incur the cost, then come to the Commission with a showing that its expenditures were reasonable, before collecting reimbursement from the ratepayers. (ORA/Wilson, Transcript, 512:23-513:6.) This treatment does not increase the risk to the company (Id., 512:16-22.), whereas the treatment proposed by Cal-Am, and that set forth in the Proposed Decision, greatly increases the risk to the ratepayers.

As the Proposed Decision correctly points out, "Under ORA's ratemaking proposal, at least the same party carrying the risk would have the responsibility and incentive to pursue the contaminators." (Proposed Decision, pp. 18-19.)

² ORA notes that, within the meaning of § 54.1 of the Civil Code, adequate telephone facilities are those which are accessible to the disabled as well as to the hale. Whether the lack of a service number closer than Illinois (Transcript, Vol. 13, Statement of Tamara O'Kelly, 1060:28 – 1061:6) constitutes reasonable service under § 451 is not a question that this proceeding need address, but it is clear at any rate that the statute's requirement concerning "telephone facilities" is not offended by it.

However, if the costs of cleanup are put into rate base, the company's incentives to expend resources to reclaim those costs are gone. If, as the Proposed Decision proposes, half the cleanup costs are entered into rate base, the utility will have an incentive only as far as its half is concerned. The decision in this case will be public, and therefore available to the third parties responsible for the contamination. There is every reason to believe that those third parties will offer less in settlement, knowing that Cal-Am is collecting the other half from its ratepayers. There is every reason to believe that Cal-Am will be more likely to settle for a lesser amount if the ratepayers are yoked with half the cost. And there is *no* reason to believe that Cal-Am will then come before the Commission asking for permission to return any money to those ratepayers, especially if the proposal at p. 20 of the Proposed Decision is adopted (see below).

The Proposed Decision also contains a factual error at p. 20 where the positions of the parties are contrasted. The first sentence is correct: "CalAm's proposal gives itself 100% protection and leaves ratepayers totally dependent on CalAm to pursue recovery." The second sentence, on the other hand, is erroneous: "ORA's proposal leaves CalAm shareholders 100% at risk for all losses." That statement is wrong, because ORA's proposal only has Cal-Am bearing the whole risk *initially*. The company can obtain permission from the Commission to collect from the ratepayers any part of the costs that are not collected from the contaminators. The Proposed Decision, on the other hand, guarantees that ratepayers must pay 50% of the costs initially, and, as stated above, if they are required to pay half the cost up front, the utility will have less incentive to pursue complete reimbursement.

There is also legal error in the Proposed Decision at p. 19, where the Proposed Decision states: "Second, there is insufficient evidence in the record to support a disallowance based on ORA's argument that the contamination problems were or should have been reflected in the Citizens acquisition price." This is error

because the duty of investigating with due diligence is a basic discovery concept in tort law. [See, e.g., *Kronisch v. United States* (1998) 1998 U.S. App. LEXIS 29363 at **17 – 18; *Cossman v. DaimlerChrysler Corporation* (2003) 108 Cal.App. 4th 370, 2003 Cal.App. LEXIS 638 at **20 – 21.] There is no need to show “evidence” that Cal-Am should have investigated and, having investigated, should have known about the contamination problems.

In addition to these factual and legal errors, the Proposed Decision’s proposal, at p. 20, for splitting “any eventual losses” between Cal-Am’s shareholders and its ratepayers, sets up a process that is highly cumbersome, and makes relief retrospective for the ratepayers, the parties the least able to bear the costs. Further, the awkward process it sets up is vague concerning what kind of “affirmative showing” will be required of the utility in the next GRC in order to establish that “reasonable progress has been made”. As Cal-Am pointed out at the February 25, 2004 oral argument (Transcript, Vol. 13, 1023:20 – 1027:14), the Commission’s workload is so heavy and its resources so taxed that it cannot properly work with the swiftness that would be convenient to the parties before it. What this means for ratepayers is that the resources they will be required to put forward under the Proposed Decision’s proposal – a relatively far greater investment than it would be for Cal-Am, American Water Works, or RWE – will not be returned to them timely but only after extensive hearings and years of waiting. Given that *none* of the process is in their control, this would be unjust even were they to receive their entire investment back. But, as has been noted above, the Proposed Decision’s proposal requires the ratepayers to absorb half the cost.

III. RECOMMENDATION

The Commission should change the Proposed Decision’s ratemaking proposal with respect to the recovery of costs occasioned by the necessary cleanup of contamination by third parties, to require the utility to bear the initial cost of

cleanup rather than the ratepayers. To that end, the Commission should follow standard ratemaking practice and adopt ORA's proposal that the utility establish a memorandum account in which to track the expenses, then apply to the Commission for reimbursement of any uncollected amounts from the ratepayers. Changes subdivision made to pages 17-20 as shown below. The Findings of Fact, Conclusions of Law, and even the Ordering Paragraphs do not mention the contamination issue; therefore no deletions are required to those portions of the Proposed Decision. However, ORA recommends that the Proposed Decision be modified consistent with these comments, and that the following Ordering Paragraph be added:

Cal-Am shall pursue collection of the costs of cleanup of contamination from the party or parties responsible for the contamination. The utility shall track all expenses it incurs in such pursuit. When each proceeding involved in that pursuit is concluded, Cal-Am will apply to us, in its next GRC for the district on whose behalf the expenses are incurred, for reimbursement of those costs from the ratepayers of that district. Cal-Am will be able to obtain such reimbursement in rates only to the extent that it can make a showing that the costs incurred were reasonable. To the extent that Cal-Am is unable to obtain a judgment for, or chooses to enter a settlement for less than the full amount of, the expenses of cleanup, it must make showing that its conduct of the case(s) and/or its decision to settle was reasonable, before we will order any part of the shortfall to be paid by the ratepayers.

IV. CONCLUSION

Cal-Am's shareholders, like its ratepayers, did not create the contamination problems in their districts. But, unlike those ratepayers, they had a vote in who would act as their management. Unlike those ratepayers, they had a choice of which properties to accumulate and which to leave alone. Unlike the ratepayers, they had the opportunity and the resources necessary to investigate, with the due

diligence expected of a buyer, the property before acquiring it, so as to assess the risk and potential profit involved in the contamination. Unlike the ratepayers, they have the resources and time to pursue reimbursement from third-party contaminators. Under these circumstances, it is unjust and unreasonable to require the ratepayers to bear even half of the initial cost of cleanup. The Commission should adopt ORA's recommendations and put the initial burden on the shareholders. The resolution of this issue set forth in the Proposed Decision fails to assure the ratepayers of just and reasonable rates as required by § 451 and the Commission should correct this error.

Respectfully submitted,

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March 1, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a certified copy of the foregoing document **“COMMENTS OF THE COMMISSION’S OFFICE OF RATEPAYER ADVOCATES ON THE PROPOSED DECISION OF ALJ MCVICAR”** on all known parties to **A.02-09-030, et al.** who have e-mail addresses. Any appearance that has not provided the Commission an electronic mail address, was served by first class, paper mail, a copy properly addressed to each party.

Executed in San Francisco, California, on the **1st** day of **March, 2004**.

Sue Ann Muniz